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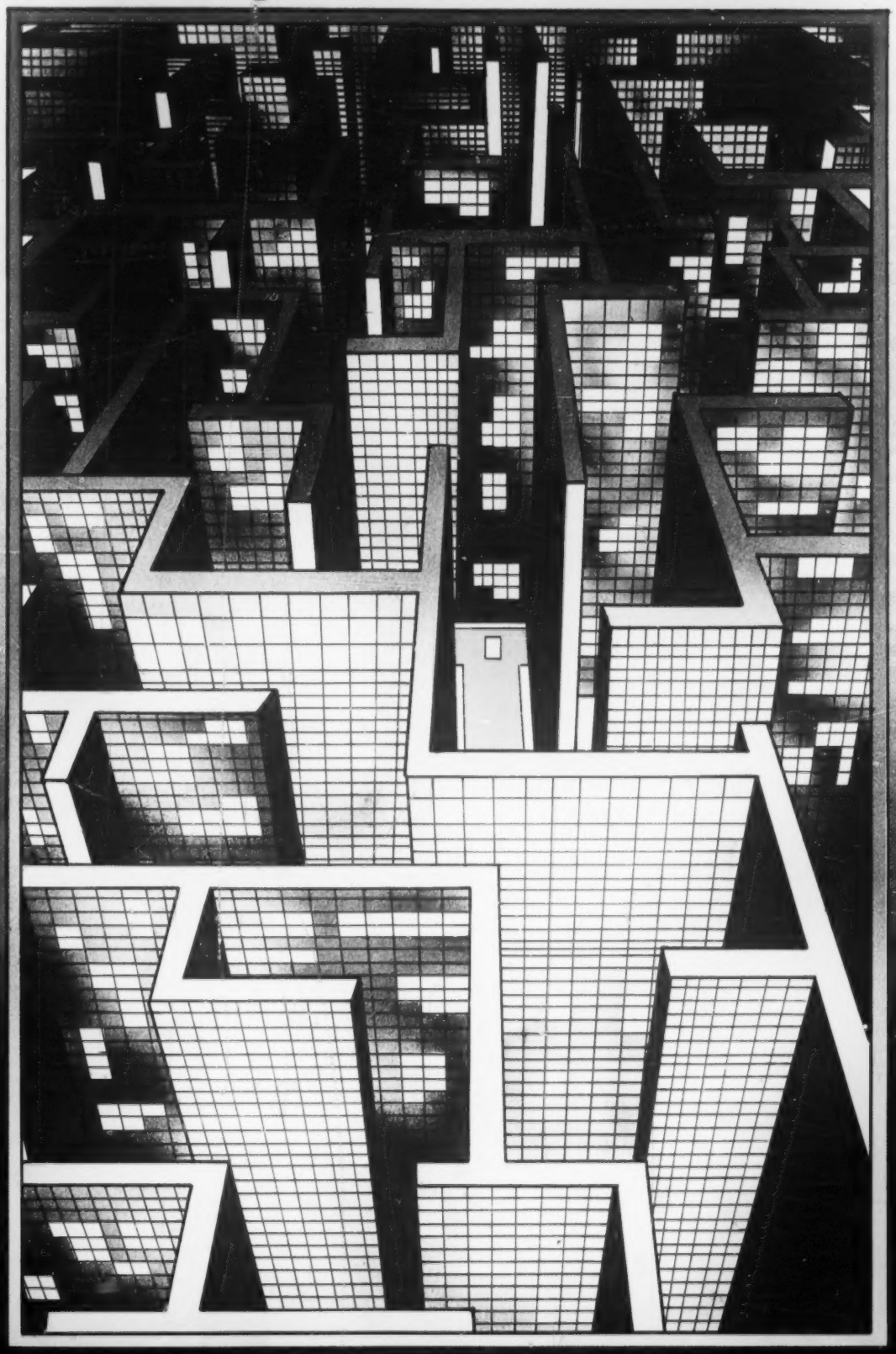
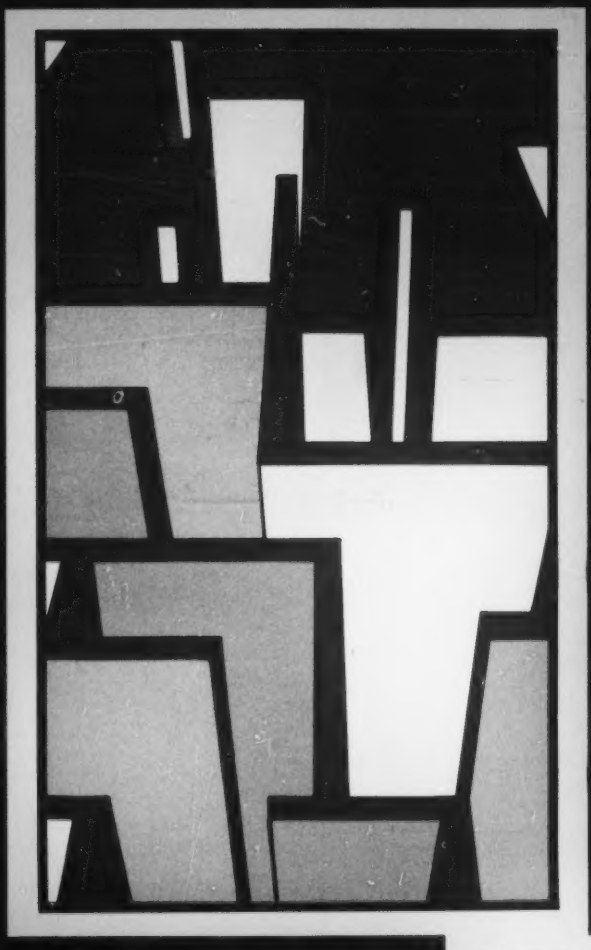
1992 Dodge/Sweet's Construction Outlook



Outlook '92



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McGraw-Hill Construction Information Group

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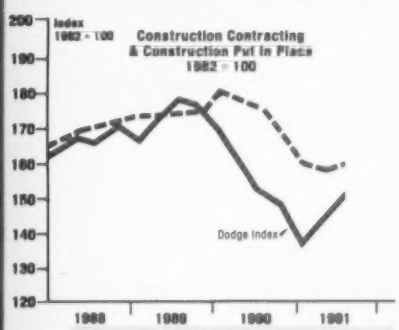
A NEW BUILDING CYCLE BEGINS



How you perceive the economy's recovery from the 1990/91 recession depends a lot on your vantage point. Incumbent politicians concerned about re-election are inclined to say "Of course it's happening," and cross their fingers. Business economists say, "It's probably happening," as they hedge their bets. Consumers say "It won't happen without us," and continue to sit on their credit cards. Bankers ask, "What recovery?", as they unload their nonperforming assets.

Recovery of the construction industry is less controversial. The industry's leading indicator, the Dodge Index of Construction Contracting, has been on its way up since early in the year. Nevertheless, a broad-based recovery is still more promise than reality. At the extremes, single family homebuilding is coming along nicely, while conditions in the deeply depressed commercial real estate market have only worsened through 1991.

The Dodge Index (see chart) establishes that the revival of contracting for new construction began early in 1991. Prior to that, the value of newly started construction of all kinds fell from its peak (1989's third quarter) for six consecutive quarters, shrinking by 25 percent along the way. Two quarters of rebound have so far restored only a small portion of that loss.

The 1991 turnaround of construction contracting is just now beginning to pay dividends on the job site. The value of construction put in place, which measures expenditures for materials and wages as work progresses, typically lags contracting by six months. Its last peak (1990:I) arrived right on schedule — two quarters after the peak of contracting. Declining through all of 1990 and half of 1991, construction expenditures now appear ready to follow the Dodge Index upward.

Once that sequence occurs, it will be more appropriate to talk about recovery. Meanwhile, a better term to describe what is happening in 1991 would be "rounding the lower turning point" — the transition from decline to expansion.

Anatomy of The Lower Turning Point

The main issue to be addressed in this 1992 Construction Outlook concerns the renewed expansion of the building business. Before that, it is worth considering what kind of turnaround is in progress. In the symbolic alphabet of cyclical turning points, the letters L, W, V, and N, cover most of the possibilities.

L The worst case scenario is decline followed by stagnation. But that won't happen until population growth ceases altogether (if even then), and ZPG isn't due for at least another 50 years. Forget it.

W Aborted recovery, a.k.a. the double-bottom recession, is what actually happened the last time around (1980-1982). The risk of falling backwards in the near future, however, is low. A premature tightening of credit could do it, but with inflation under control and the economy's progress in doubt, Fed monetary policy is stimulative — unlike in the early 1980s.

V Steep decline followed by equally steep recovery hasn't been experienced since the mid-1970s. To produce similar recovery in 1992 would require, among other things, a great surge of residential building. With the multifamily housing market as it is, that just can't happen.

N Stands for "none of the above." The alphabet doesn't offer a symbol for the most likely recession/recovery sequence for the early 1990s: steep decline, followed by shallow recovery. The reasons for this condition are all too familiar.

Legacy of the 1980s

A supposed side benefit of recession is that it restores balance to a distorted marketplace. Often it does, but for the building industry this is not one of those times. The excesses of the mid-1980s, which led to the recession of 1990/91, are still far from resolved. They remain as obstacles to the emerging recovery.

Credit Scarcity

The banking crisis of 1989/90 may have passed, but its fallout will linger as a cloud over real estate finance for years to come. Regulation and reform of the banking system have replaced the free and easy ways of the 1980s when imprudent lenders were heaping funds on overeager developers.

Regulation concerns cleaning up the mess. For what is left of the S&L industry, it means the taxpayer bailout of more than 10 million depositors and the liquidation of several hundred billion dollars of questionable assets. For commercial banks, it means writing down overvalued real estate holdings, beefing up capital, and tightening standards on new lending — all of which involve taking sizeable losses.

Reform is about not letting it happen again. For the surviving S&Ls, FIRREA has reversed earlier deregulation, ordering thrifts back to the relative safety of single family home loans. Reform legislation covering the bigger commercial banking industry is still making its way through Congress.

Developments seem to be gravitating toward a synthesis along these lines:

- S&Ls are out of commercial real estate development altogether, and will support residential building on a greatly reduced scale. Mortgages are OK, but ADC loans are not.
- Commercial banking is moving toward consolidation and conservatism. Consolidation will leave fewer, larger, more profitable banks reducing the number of failures the FDIC must cover. High risk lending (junk bonds, third world loans, and — yes — commercial real estate) has been curtailed to the extent that the Administration blames overzealous bank regulators for stalling the economy's recovery.

In contrast to the high risk/high yield lending strategy of the 1980s, safety of investment principal will be a major consideration in the 1990s. Only the most promising commercial projects will be eligible for financing.

The Commercial Glut

The other side of the banking breakdown of the 1980s is the unsupportable tax-sheltered building boom that it financed. Almost every type of commercial building that could benefit from accelerated depreciation — and that includes offices, hotels, shopping centers, apartments, condos, and more — was overdeveloped during the span between ERTA (1982) and the Tax Reform Act (1987) when buildings were created to shelter incomes, not people.

The commercial building boom reached its peak in 1985. Since then the annual supply of newly started construction has been reduced by more than 50 percent, yet the glut of empty space continues to haunt the construction market. Even at the extremely low 1991 rate of building (which is far below that of even the 1980-82 recession), vacancy rates hang stubbornly high. Until this huge inventory of available space is assimilated, it is premature to consider the recovery of commercial building.

Public Priorities

The budget resolution of 1991, which established a new course for deficit reduction (after the S&L bailout drove the final nail into the coffin of the Gramm-Rudman scheme), ostensibly caps most Federal construction and other domestic programs in order to prevent dissipating the peace dividend. Mounting pressure to reopen last year's budget deal in light of recent progress in arms reduction isn't likely to have much effect on 1992 appropriations. Until that happens, more funds can be made available for one domestic program by cutting another, or by adding a new tax or user fee (which the President threatens to veto). Under these constraints, Federal support for construction programs is limited to growth of the tax base itself as the economy recovers.

Things are tighter for state and local governments where recession has eroded tax revenue while Medicaid and "corrections" costs continue to soar. Because state governments do not enjoy the luxury of open-ended deficit financing that the Federal government does, states have enacted "extremely austere" budgets for fiscal year 1992. State policymakers are not at all confident that even these plans will stick.

Economic Ennui

Few, if any, forecasters expected that the next cycle of economic expansion would be ushered in by a strong rebound from the 1990/91 recession. Even in the context of low expectations, recent developments have been disappointing, and it isn't likely that this lethargic recovery will accelerate soon. The huge Federal deficit stands in the way of a tax cut or other forms of fiscal stimulus, and the Fed's attempts at monetary jump-starts have so far gone largely ignored.

A weak recovery — but without setback — remains the assumption underlying this construction forecast. After two years of virtual standstill, total output (real GNP) will expand at an average rate of 2½ to 3 percent in 1992 and 1993. These are not impressive numbers at the front end of a business cycle. By contrast, during the first two years of recovery from the recession of the early 1980s, GNP growth averaged a more vigorous 5 percent.

One side effect of a half-speed recovery is below-average inflationary pressure. As consumer prices rise at only 3 to 4 percent per year, the Fed has ample room to err on the side of monetary ease. Single digit mortgage rates are here to stay for a while and will be supportive of single family home sales. Despite relatively low interest rates, however, the *availability* of acquisition, development and construction loans for income properties will be limited as financial institutions shy away from real estate investments.

Support in the 90s

Although several unresolved problems left over from the 1980s hinder a clean break from the past, there are some positive forces to sustain the construction/building materials industry through its upcoming cycle.

Generally Supportive Demographics

It is hard to think of anything more important to the demand for construction than the growth of its demographic base. Within that base, the midlife cohort (35 to 55) is easily the best part.

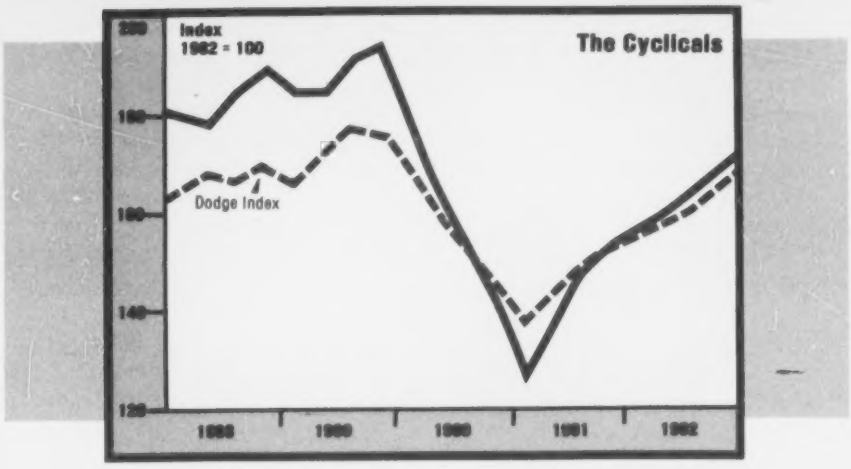
The largest generation in American history is now reaching middle age — the age of acquisition. In addition to this critical support at the center of the population's age spectrum, above-average growth can be found at the ends as well: 0 to 15, and 65-plus. These ongoing developments translate into renewed strong demand for single family housing and institutional buildings in the post-recession era.

One demographic exception is the young adult cohort (18 to 35) which will be shrinking in the years ahead. More about that later.

Beyond Demographics

A neglected and deteriorating infrastructure must be upgraded, and the improving prospect of a peace dividend could shift existing priorities in that direction. Additions and alterations to aging nonresidential structures represent an offset to temporarily depressed conditions in new commercial building markets.

These are just some of the supportive developments which will determine the amount and types of construction coming forth in the early 1990s.



Construction Contracting In 1992

The main intent of this booklet is to provide specific estimates of construction contracting in 1992, the first full year of the coming upswing. For analytical purposes, building types are grouped under two broad headings: cyclical and stable.

The cyclical group consists of one family housing and income properties, and accounts for approximately three-quarters of the total. Largely privately financed, this group is highly sensitive to financial and economic conditions.

The stable group, consisting of institutional buildings and public works construction, is funded mostly by Federal, state, and local governments, and is relatively insulated from the vagaries of the money market.

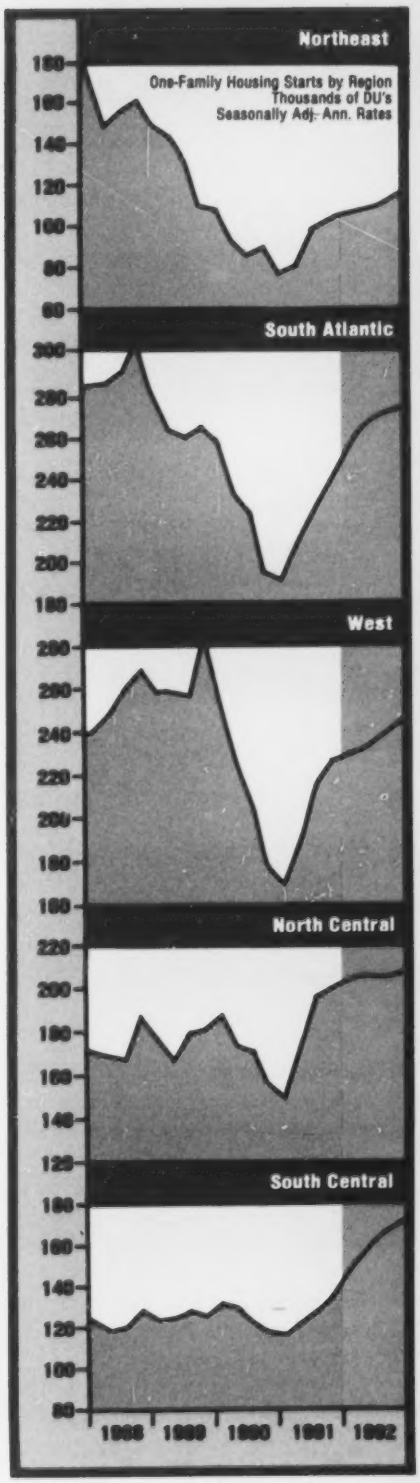
The Cyclicals

One Family Housing

Normally one of the most volatile of all the building categories, one family housing enjoyed a period of uncharacteristic steadiness through the mid-1980s. Inevitably, however, homebuilding showed its true nature with a decade-ending crash in the midst of a credit crisis and recession.

Before the crash, output of one family dwellings held close to one million units per year from 1983 through 1989 with remarkably little variation. Favorable demographics and relatively steady mortgage rates provide most of the explanation for this extended plateau. During the second half of the 1980s, an exceptional number of people (approximately 9 million) joined the ranks of the 35 to 54 year age group. This is the prime age range for homebuying — whether it involves the move from apartment to starter home (the early end of the age spectrum) or upgrading and the purchase of a second home (the other end). With just as many folks entering mid-life in the early 1990s, we'd probably still be turning out a million houses a year had it not been for the S&L collapse of 1989 and the recession of 1990/91. Instead, one family starts fell off their plateau, averaging only 825,000 in 1990 and 1991.

The huge one family housing market represents the building industry's main chance for recovery in the near future. The demonstrated potential of one million units per year is still there, and to regain it would mean an improvement of nearly 25 percent over 1991's estimated total of 810,000 units. The economy's recovery from its recent recession will remove one obstacle, but that isn't enough. Events of the past several years have shaken consumer confidence, and have left the thrift industry a hollow



One Family Housing Starts (Thousands of Dwelling Units)

Region	Pre-Recession Equilibrium	Recession Low (1991:I)	Latest Rate (1991:III)	1991 Est.	1992 Est.	Percent of Pre-recession Level
Northeast	150	75	100	90	110	75
North Central	175	150	200	180	205	115
South Atlantic	275	190	220	215	265	95
South Central	175	115	125	125	160	90
West	250	170	205	200	235	95
U.S. Total	1,025	700	850	810	975	95

shell. To expect a typically strong first-year rebound of home building is not realistic.

Geography adds another dimension to the decline/recovery sequence of one-family housing starts. It requires answers to such questions as: Where was the regional concentration of homebuilding when the market was on its million unit plateau? Which regions took the heaviest losses in the 1990/91 setback? And which areas have been leading the recovery since the beginning of this year?

Two regions — the South Atlantic and the West — together account for slightly more than half the national annual potential of just over one million single family housing units. Along with the boom-and-bust Northeast, these regions absorbed the entire 1990/91 national decline. Over those two years, home building in the three coastal regions fell 25 percent, while the two central regions held steady.

Six months of recovery (1991:I to 1991:III) show that home building is up in *all five* regions, but with little uniformity. Only one area, the West, so far resembles the national rate of recovery at 20 percent (seasonally adjusted). The rustbelt regions — the Northeast and the North Central — along with the South Atlantic are leading the recovery with gains of 30 to 35 percent, while the South Central is trailing with a nominal 10 percent improvement over its recession low. Because most of 1991 is now history, it is evident that recovery is "too little/too late" to avoid another decline of the national total. As bad as that sounds, however, it compares favorably with the two-year cyclical low of 650,000 units during the 1981 and 1982 slump.

In the first full year of recovery — 1992 — the "Coastal Three," which bore the brunt of the 1990/91 decline, are the obvious candidates for maximum gain. None of them is likely to make it all the way back to pre-1990 volume in 1992, but the South Atlantic and the West will come close. The Northeast will not.

These regional variations on the recovery theme add up to a national total of 975,000 one family housing starts for 1992, a year-to-year gain of 20 percent. By the second half of the year, the annualized rate of building could slightly exceed one million units, and will then stabilize for the next few years.

(Note: Reference to single family homes conforms to F.W. Dodge definitions, which differ from those of the U.S. Department of Commerce. In the borderline area of townhouses, for example, Dodge considers some types of units to be multifamily which Census classifies as one family homes.)

Income Properties

The grouping of multifamily housing with offices, shopping centers, hotels, and other commercial real estate gathers all the construction industry's problem markets together in one untidy bundle. The justification for this assemblage is behavioral: all were participants in the mid-1980s tax shelter boom, all were vastly overdeveloped, and all were in decline long before the recession of 1990/91 came along.

The decline and fall of the income property group since its 1985 peak (at 1.85 billion square feet) hasn't played according to the standard cyclical script any more than one family housing has. Ordinarily, commercial building — like other forms of business capital spending — is a victim of recession, and *follows* the general economic downturn. This time it was ahead of the action by several years. It underscores what unusual times the 1980s were.

A two-stage decline of commercial building began as long ago as 1986, initially as a reaction to earlier overbuilding which was becoming apparent as vacancy rates took off. By 1989, contracting had been reduced 30 percent to 1.32 billion square feet, but that was still more than the market could digest. Recession accelerated the adjustment process. A further decline of 40 percent over the next two years left contracting at only 700 million square feet by 1991 — the lowest volume since 1975!

It is probably safe to say that the 1990/91 recession has finally established the bottom of the six year slide of contracting for income properties. What is needed to revive this deeply depressed market?

- Recovery of the economy is one requirement, of course. It appears to be happening, although you have to look hard for evidence. Even when recovery is confirmed by rising income and employment, there's the usual business investment lag to wait out. Experience shows that it can take as much as a year to bring idle capacity into use, and that applies to offices and shopping centers as well as factories.
- When business is ready to expand, will bankers be ready to finance them? Presently, most lenders would rather reduce their inventory of overvalued commercial real estate. Furthermore, banker resistance to real estate development will last as long as the existing surplus of space continues to depress values. Assimilation of the remains of the mid-1980s building boom is the other prerequisite to recovery, and the prospect isn't encouraging.

Six years have elapsed since the commercial building boom topped out. Since then, the annual supply of new space has been reduced by half, yet vacancy rates remain stubbornly high and steady. The lack of assimilation of excess space has as much to do with the demand for it as with its oversupply.

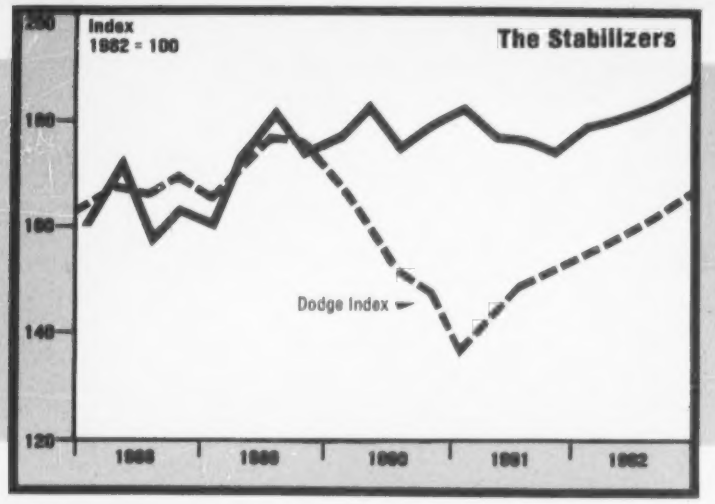
No single event explains the stickiness of commercial building vacancy rates. As the building boom receded from its peak, it took several years before diminishing supply aligned with the demand for commercial space (such was the extent of overbuilding in the mid-80s). By the time the market approached equilibrium via reduced supply, recession took a large bite out of the demand side of the market. Thus, despite a sizeable secondary reduction of building in 1990 and 1991, high vacancy rates persist.

Almost unnoticed, another variable — demographics — has crept into the equation. Just as midlifers are the main support for single family housing, *young adults* are at the core of the demand for commercial properties. This cohort is the source of additions to the labor force (offices), provides the majority of the nation's renters (apartments) and first time home buyers (condos). They are also found in abundance in shopping centers, and, increasingly, hotels. It was during the second half of the 1980s that the "baby bust" — the group defined by the low birth rates that prevailed in the late 1960s and the early 1970s — began to reach young adulthood.

The implications for commercial building are profound. In the first half of the 1980s, this 18 to 35 age group was still growing. In the second half of the 1980s, its growth came to a halt. *In the first half of the 1990s, it will shrink by 5 million persons!*

Commercial building in the post-recession era will be handicapped not only by tight-fisted bankers, but by a far less supportive demographic environment than the one that existed when the industry emerged from the 1980/82 recession. Even under the most optimistic assumptions regarding assimilation and removals of existing space, vacancy rates will recede only gradually, building will recover slowly, and excess capacity — especially of offices and hotels — will be a burden for many years to come.

Stability of commercial contracting in 1992, following the large back-to-back declines during the recession years, is the best that can be expected for the near term. Next year's office building is forecast at 95 million square feet (–5 percent), retail building at 345 million (–4 percent), and hotels/motels at 30 million



(unchanged). With little prospect for near-term improvement in the deeply depressed multi-family housing market, total square footage for the income property group will remain close to where it is for another year or more.

The supply/demand distortion of this part of the construction sector prompted by the excesses of the mid-1980s were all too apparent before the onset of the 1990/91 recession. The recession has come and gone without changing much except to hasten the inevitable correction.

The Stabilizers

Institutional Buildings

Annual square footage of new institutional construction hasn't varied more than 2 percentage points in the last four years, despite upheaval in the credit markets and recession. And 1992 will make it five in a row. Compare that with the commercial and industrial part of the nonresidential building sector which rose and fell by more than 50 percent during the tumultuous 1980s.

The inherent stability of institutional building (schools, healthcare facilities, public administration buildings) stems partly from its close link to slowly changing demographic developments and its relative independence of the money market. Nevertheless, the apparent stability of *total* institutional building conceals important dynamics of the major components within this group.

There are cycles in institutional building, but they aren't the kind normally associated with the volatile construction business. Institutional building cycles tend to be generational, the classic case being the impact of the '50s generation on the nation's educational system during the '60s and early '70s.

Now its happening all over again. The so-called "echo of the baby boom" — the resurgence of births which began in the mid-1970s — reversed a decline of educational building in the early 1980s, giving rise to a new wave of building. Since 1981/82, the low point of the "long cycle" of educational building — square footage has increased every year. By 1990, primary school construction had tripled and high school building had doubled.

Educational building is not only the biggest part of the institutional category, but is also the most predictable. Contracting for health care facilities (hospitals, clinics, nursing homes) which depend on both public and private sources of funding, is more complex. As the population ages, its needs for healthcare facilities increases. This built-in growth trend, however, has been temporarily interrupted. During the mid-1980s, a mini-boom of construction of clinics and nursing homes was superimposed on the underlying trend, and it bore a striking resemblance to the tax shelter boom that was so prevalent in commercial real estate development at the time. Unlike the commercial building collapse since tax reform, however, healthcare construction has experienced no worse than a gentle letdown over the past few years. Apparently the strong demographic support behind the healthcare industry is largely responsible for the different outcome, and little, if any, further decline is anticipated.

Another category of institutional construction which has shown extraordinary expansion — from less than 20 million square feet in 1980 to the current 40-plus million — is public buildings. It is a sad commentary on the past decade that prisons now make up more than half of this total, up from 25 percent over the ten year span. A recent compilation of states' plans for 1991/92 indicates a further sizeable increase.

Although the same needs that have supported a high volume of total institutional building even through the 1990/91 construction recession are still as pressing as ever, they are temporarily in conflict with a fiscal squeeze on state governments. As priorities are re-ordered, a token deferral of building programs may be an appropriate gesture. For 1992, it would be prudent to anticipate a minor setback of institutional contracting of up to 5 million square feet (a nominal one percent of current volume), which would be confined largely to educational building.

Public Works

Contracting for public works construction has remained within the narrow range of $43 billion and $45 billion annually for the past five years — high, but not going anywhere. Together with institutional building, this infrastructure work — highways, bridges, mass transit, water resources, and waste treatment facilities — provides an element of stability to an otherwise turbulent construction market, but little if any growth. This contrasts with the early 1980s when public works construction contributed significantly to the expansion of total construction.

Much of the recent steadiness of public works contracting has been due to the consistent funding of highway and bridge construction via the 1987 Surface Transportation Act which, in effect, extended the 1982 STA for an additional five years. Transportation-related construction constitutes more than half the total of all infrastructure work.

Expiration of the 1987 Surface Transportation Act last September 30th offers opportunity to lift off the plateau once Congress enacts a new Federal-aid highway program to replace it. The virtual certainty of a higher level of spending carries with it the risk of an interruption of funding. If Congress fails to move the stalled highway/transit bill along soon, 1992 could bring a temporary setback en route to the next five year master plan.

The risk of a lower 1992 total of highway/bridge construction is not very great. With nearly $6 billion of unobligated funds, the Highway Trust Fund could be tapped to sustain the current rate of contracting through the end of the year. It is assumed that the legislative hassle will not drag far into 1992. Even if contracting is temporarily interrupted during next year's first quarter, experience shows that it can be made up quickly once new funds are appropriated. With the economy's recovery needing all the support it can get, DOT will likely be under orders to get its funds out as fast as possible.

Both versions of the new transportation program — the Senate's at $123 billion, and the House's at $150 billion — would commit substantially more Federal funds to transpor-

tation that the program they replace, which delivered $88 billion over the past five years. These totals include DOT spending for purposes other than construction, but they do not include the partial matching contributions by states, nor do they include construction initiated by states on their own.

A proposed 5 cents/gallon fuel tax increase — close on the heels of last December's 5 cents — has been the major barrier for passing new highway legislation. Once that point was yielded (presumably satisfying the President's "no new taxes" edict and thereby defusing his veto threat), the highway bill was reduced to procedural matters: division of the proceeds between highways and mass transit, and sharing of the cost between Federal and state governments.

Another sizeable category of public works construction, sewers and waste treatment facilities, has been subjected to both positive and negative influences in recent years. At present, the negative forces seem to have the upper hand.

During the final years of the last decade, compliance with the 1987 amendments to the Clean Water Act caused contracting to surge above $7 billion for three consecutive years (up from an average of $6 billion for the three previous years). By 1990, however, not only had this legislation lost some of its urgency, but the means of financing the construction of waste treatment facilities underwent a major change. In the hope of gaining more leverage from Federal dollars, EPA grants to states and municipalities have been shifted from direct construction *grants* to establishing of state revolving funds (SRFs). States are required to supplement Federal contributions by 20 percent, and the resulting SRFs become the source of construction *loans* (there's a difference), or the foundation on which to base a state bond issue to fund waste treatment projects.

One consequence of this changeover has been a setback for the construction of waste treatment facilities. With direct Federal support no longer generally available, the value of construction contracting has settled back between 10 and 15 percent from its 1987/88 peak. Only a small improvement — on the order of 2 or 3 percent — is indicated for 1992.

The value of contracting for *total* public works construction, paced by its dominant transportation component, will advance about 4 percent in 1992. This potential gain, which hinges on pending legislation, marks the beginning of a period of expanding infrastructure work after several years of high-level stability.

1992 National Estimates
Dodge Construction Potentials

		1991 Preliminary	1992 Forecast	Percent Change 1992/91
Nonresidential Buildings				
Floor Area (millions of square feet)	Office Buildings	100	95	-5
	Stores & Other Commercial	360	345	-4
	Manufacturing Buildings	105	100	-5
	Total Commercial & Manufacturing	565	540	-4
	Educational	160	155	-3
	Hospital & Health	67	65	-3
	Other Nonresidential Buildings	146	145	-1
	Total Institutional & Other	373	365	-2
	Total Nonresidential Buildings	938	905	-4
Contract Value (millions of dollars)	Office Buildings	$ 12,375	$ 12,350	—
	Stores & Other Commercial	19,100	18,900	-1
	Manufacturing Buildings	7,950	7,875	-1
	Total Commercial & Manufacturing	$ 39,425	$ 39,125	-1
	Educational	$ 17,225	$ 17,050	-1
	Hospital & Health	9,100	9,025	-1
	Other Nonresidential Buildings	15,525	15,875	+2
	Total Institutional & Other	$ 41,850	$ 41,950	—
	Total Nonresidential Buildings	$ 81,275	$ 81,075	—
Residential Buildings				
Dwelling Units* (thousands of units)	One Family Houses	810	975	+20
	Multifamily Housing	190	200	+5
	Total Housekeeping Residential	1,000	1,175	+18
Floor Area (millions of square feet)	One Family Houses	1,465	1,770	+21
	Multifamily Housing	210	220	+5
	Nonhousekeeping Residential	30	30	—
	Total Residential Buildings	1,705	2,020	+18
Contract Value (millions of dollars)	One Family Houses	$ 83,300	$ 103,325	+24
	Multifamily Housing	12,150	13,125	+8
	Nonhousekeeping Residential	3,250	3,300	+2
	Total Residential Buildings	$ 98,700	$ 119,750	+21
Nonbuilding Construction				
Contract Value (millions of dollars)	Transportation Construction	$ 28,750	$ 30,250	+5
	Environmental Construction	14,800	15,200	+3
	Total Public Works	$ 43,550	$ 45,450	+4
	Utilities	$ 5,000	$ 5,200	+4
	Total Nonbuilding Construction	$ 48,550	$ 50,650	+4
All Construction				
Contract Value (millions of dollars)	**Total Construction**	$ 228,525	$ 251,475	+10
	Dodge Index (1982=100)	145	160	

*F.W. Dodge basis

1992 Regional Estimates

Dodge Construction Potentials

Northeast

CT, ME, MA, NH, NJ, NY, PA, RI, VT

Contract Value (millions of dollars)

	1991 Preliminary	1992 Forecast	Percent Change 1992/91
Nonresidential Building			
Commercial & Manufacturing	$ 6,925	$ 6,600	-5
Institutional & Other	8,250	7,975	-3
Total	$15,175	$14,575	-4
Nonbuilding Construction	$10,225	$10,550	+ 3

	1991 Preliminary	1992 Forecast	Percent Change 1992/91
Residential Building			
One Family Houses	$ 9,950	$12,225	+ 23
Multifamily & Nhskpg.	3,100	3,050	-2
Total	$13,050	$15,275	+17
Total Construction	$38,450	$40,400	+5

North Central

IL, IN, IA, KS, MI, MN, MO, NE, ND, OH, SD, WI

Contract Value (millions of dollars)

	1991 Preliminary	1992 Forecast	Percent Change 1992/91
Nonresidential Building			
Commercial & Manufacturing	$ 9,200	$ 9,375	+2
Institutional & Other	9,150	9,425	+3
Total	$18,350	$18,800	+2
Nonbuilding Construction	$10,400	$10,950	+ 5

	1991 Preliminary	1992 Forecast	Percent Change 1992/91
Residential Building			
One Family Houses	$18,950	$22,800	+20
Multifamily & Nhskpg.	2,975	3,175	+7
Total	$21,925	$25,975	+18
Total Construction	$50,675	$55,725	+10

South Atlantic

DE, DC, FL, GA, MD, NC, SC, VA, WV

Contract Value (millions of dollars)

	1991 Preliminary	1992 Forecast	Percent Change 1992/91
Nonresidential Building			
Commercial & Manufacturing	$ 7,100	$ 7,025	-1
Institutional & Other	8,525	8,150	-4
Total	$15,625	$15,175	-3
Nonbuilding Construction	$ 8,000	$ 8,400	+5

	1991 Preliminary	1992 Forecast	Percent Change 1992/91
Residential Building			
One Family Houses	$19,450	$24,775	+27
Multifamily & Nhskpg.	3,450	3,850	+12
Total	$22,900	$28,625	+25
Total Construction	$46,525	$52,200	+12

South Central

AL, AR, KY, LA, MS, OK, TN, TX

Contract Value (millions of dollars)

	1991 Preliminary	1992 Forecast	Percent Change 1992/91
Nonresidential Building			
Commercial & Manufacturing	$ 5,575	$ 6,125	+10
Institutional & Other	6,350	6,575	+4
Total	$11,925	$12,700	+6
Nonbuilding Construction	$ 8,275	$ 8,600	+4

	1991 Preliminary	1992 Forecast	Percent Change 1992/91
Residential Building			
One Family Houses	$11,475	$15,275	+33
Multifamily & Nhskpg.	1,325	1,675	+26
Total	$12,800	$16,950	+32
Total Construction	$33,000	$38,250	+16

West

AK, AZ, CA, CO, HI, ID, MT, NV, NM, OR, UT, WA, WY

Contract Value (millions of dollars)

	1991 Preliminary	1992 Forecast	Percent Change 1992/91
Nonresidential Building			
Commercial & Manufacturing	$10,625	$10,000	-6
Institutional & Other	9,575	9,825	+3
Total	$20,200	$19,825	-2
Nonbuilding Construction	$11,650	$12,150	+4

	1991 Preliminary	1992 Forecast	Percent Change 1992/91
Residential Building			
One Family Houses	$23,475	$28,250	+20
Multifamily & Nhskpg.	4,550	4,675	+3
Total	$28,025	$32,925	+17
Total Construction	$59,875	$64,900	+8

"The Future Ain't What It Used To Be"*

It's been another down year for construction contractors and building materials suppliers — the second in a row. The most that can be said for 1991 is that it is ending better than it started. Steady improvement in contracting for new projects since early in the year assures that soon the industry's awaited recovery will be more fact than forecast. The issues for 1992: How much recovery? What kind?

Past performance says that the first full year of recovery offers a *potential* gain of 20 percent or more for construction contract value. That's how much actually came forth in the beginning years of the two previous building cycles. The 1983 recovery delivered +24 percent: in 1976 it was +21 percent. Both times, residential building dominated the early phase of expansion, and reinforcement by commercial and industrial construction arrived in the second year to keep things going. The coming expansion of the building industry, beginning in 1992, will follow this well-rehearsed script, but only up to a point. The new cycle will reveal many of the general characteristics of past recoveries, but they'll reappear in an altered state due to the unique circumstances of the 1990s.

The early dominance of homebuilding is already evident, and will become more apparent in 1992. In fact, there is little opportunity for near-term expansion in anything except single family housing which, fortunately, is the biggest category of all. It was pointed out earlier that the "income property group" (offices, apartments, etc.) has finally hit bottom, but is destined to stay there until those high vacancy rates yield. Publicly financed construction (institutional buildings and infrastructure projects), though unaffected by the 1990/91 recession, is bumping against its short-term ceiling. And that's all there is.

The 1992 outlook for total construction contracting comes down to a matter of how much the home building market can deliver.

The limits of the residential marketplace have already been identified. *Demographic developments* imply a sustainable output of up to, but not more than, one million single family units per year, although this volume could be exceeded briefly if some unrealized demand carries over from the 1990/91 recession.

Credit availability imposes another ceiling. Low mortgage rates can stimulate sales of existing homes, but if bankers are reluctant to grant construction loans, the supply of new units will be inhibited.

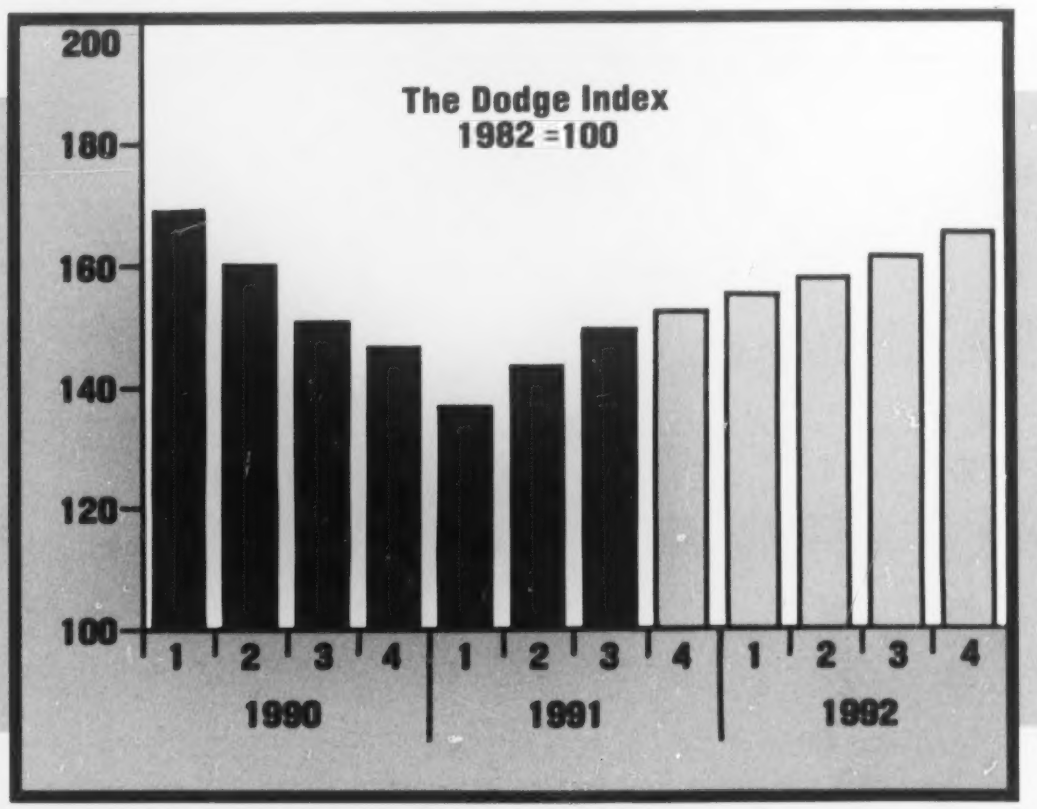
Geography is yet another short-term constraint. The depressed Northeast will be the last of the five major regions to regain its pre-recession volume of home building, and it won't be in 1992.

These limitations indicate that the 1992 potential for the recovery of single family residential building is not what it was in other "first year" situations. The estimated total of 975,000 units, at 1992 prices, would mean a gain of close to 25 percent in dollar terms. However, with little improvement in the rest of the construction market next year, this significant percentage gain in single family home building will be diluted to a 10 percent increase for total construction contract value — roughly half the first year gain of prior recoveries.

At this early stage, it would appear that the second recovery year (1993) offers opportunity for a further advance of another 10 percent, and with a better balance of residential and nonresidential building.

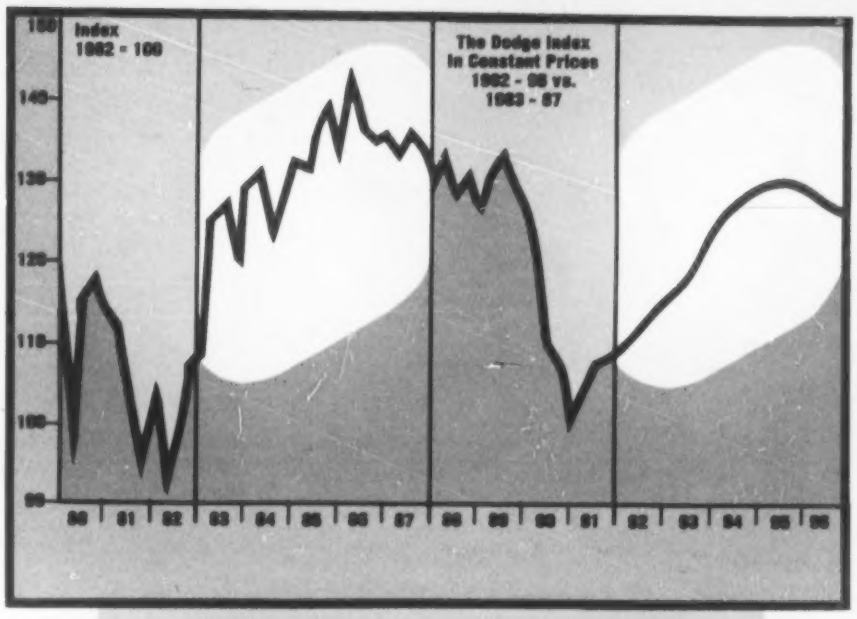
And so it goes, usually for as long as five years. As the construction industry prepares for a new period of cyclical expansion, it is easy to fall into the trap of assuming that one building cycle is not greatly different from another. There are always similarities, of course, but certain

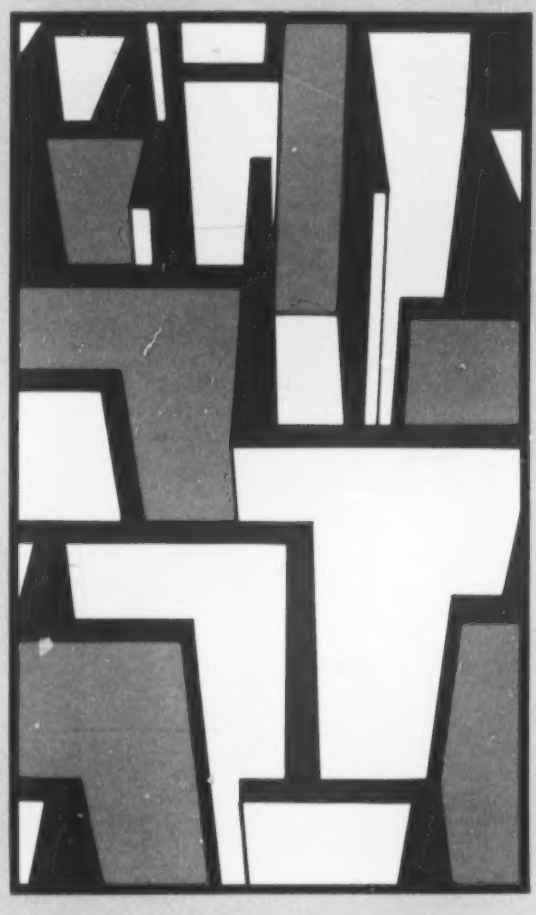
*Attributed to L.P. (Yogi) Berra



features of the future market environment will make it quite different from the 1980s experience. The "subsidy" of accelerated depreciation for income properties is long gone, and in its place is a vast inventory of empty buildings to be assimilated. The free-and-easy lending practices of the 1980s have given way to bank regulation and reform. The demographics of the 1990s will give rise to a different blend of construction needs, just as the needs of the 1980s were different from those of the 1970s.

One way to see how the building market of the 1990s will differ from that of the 1980s is to compare five year totals of construction during similar phases of the cycle — in this case, from early recovery to peak. This means matching the prospective totals for 1992 through 1996 against actual values for 1983 through 1987 (the shaded areas in the accompanying chart). The source: F.W. Dodge's Five Year Construction Market Forecasting Service. For comparability, all values are adjusted for inflation.





- **Single Family Homes** Approximately the same five year total of units will be built (5.0 million vs 5.1 million), but they will create between 10 and 15 percent more constant dollar value. In the 1990s, single family homes are averaging 1,800 square feet, 15 percent bigger than those built in the mid-1980s.
- **Income Properties** As the assimilation of 1980s overbuilding depresses this market, 40 percent less new construction will be initiated. Offices, hotels, and apartments/condos will bear most of the cutback. Retail facilities, drawing support from sustained single family home development, will be off by about 20 percent.
- **Institutional Buildings** Continuing growth of educational building will boost total institutional construction 20 percent. Hospital/healthcare needs will match but not exceed the very high 1983-87 total.
- **Infrastructure** A new highway program will help contracting for public works projects break out of its recent budgetary straitjacket. The potential gain is limited to about 5 percent, however, as other public priorities compete for the peace dividend.
- **Total Construction** Prospective gains in housing, institutional buildings and public works construction will not be large enough to offset the lingering weakness in commercial real estate development. Consequently, the five year total of construction contract value (in constant dollars) for 1992-96 is projected to fall short of the 1983-87 total by something between 5 and 10 percent. In current dollars, however, the inflated value of work contracted during 1992-96 will be greater than in 1983-87 by as much as 30 percent.

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